

# **STATEMENT OF INVESTMENT PRINCIPLES**

## **MORGAN STANLEY UK GROUP PENSION PLAN**

### **1. Introduction**

The Trustee of the Morgan Stanley UK Group Pension Plan (the "Plan") has drawn up this Statement of Investment Principles (the "Statement") to comply with the requirements of the following legislation:

- The Pensions Act 1995 and as amended by the Pensions Act 2004;
- The Occupational Pension Schemes (Investment) Regulations 2005, as amended by the Occupational Pension Schemes (Charges and Governance) Regulations 2015; and
- Subsequent legislation.

In addition to the above, the Trustee has enacted this Statement to fulfil the spirit of the Myners principles for investment decision-making.

As required under the Act the Trustee has consulted a suitably qualified person and has obtained written advice from Mercer Ltd. The Trustee in preparing this Statement has also consulted the sponsoring Company.

The Plan is primarily a Defined Contribution ("DC") arrangement though it also contains liabilities and assets from a previous Final Salary arrangement. The majority of this Statement is relevant to the DC element of the Plan. The policy relating to the Final Salary element is contained in Sections 4 to 7 of this Statement.

The Trustee's investment responsibilities are governed by the Plan's Trust Deed, and this Statement takes full regard of its provisions. A copy of the Plan's Trust Deed is available for inspection upon request.

### **2. Governance Structure**

Overall investment policy falls into two parts. The strategic management of members' assets is fundamentally the responsibility of the Trustee acting on advice from its investment consultant, Mercer Ltd, and is driven by its investment objectives as set out in Section 3 below.

The remaining elements of policy relate to the day-to-day management of the assets that is delegated to professional investment managers and is described in the Investment Policy Implementation Document (the "IPID").

In order to assist with the discussion of investment matters, the Trustee has set up an Investment Committee, members of which are a sub-set of the Trustee body. This body has been created in order to ensure that investment matters receive a sufficient degree of attention. A number of powers relating to investments have been delegated to the Investment Committee and these powers are set out in a formal Terms of Reference document. At each Trustee meeting, the Investment Committee is required to formally report back to the Trustee on any decisions taken, or any proposals that it is recommending to the Trustee.

The Trustee is committed to maintaining the accuracy of this Statement on an ongoing basis.

## **Defined Contribution ("DC") Section**

### **3. Overall Policy**

#### **3.1. Investment Objectives**

The Trustee recognises that members have differing investment needs and that these may change during the course of members' working lives. It also recognises that members have different attitudes to risk. The Trustee believes that members should make their own investment decisions based on their individual circumstances. The Trustee regards its duty to be to make available a range of investment options sufficient to enable members to tailor, to their own needs, their investment strategy.

The Trustee also recognises that members may not believe themselves qualified to make investment decisions. As such the Trustee makes available a Diversified Default Option. The Diversified Default Option places the emphasis on producing a reasonable level of real return over members' working lifetimes, but with lower volatility than that offered by a pure equity strategy, as a result of the more diversified range of assets that the Diversified Default Option invests in, and also encompasses a switch into asset classes which are designed to reduce investment risk in the years approaching retirement.

The following encapsulates the Trustee's objectives:

- To make available a range of investment vehicles which serves to meet adequately the varying investment needs and risk tolerances of Plan members.
- To have the assets managed by investment managers believed to be of high quality, i.e. where there is a suitable level of confidence that the manager/s will achieve their performance objectives.
- To provide a means by which active management can be offered with the flexibility for the Trustee to change managers proactively.
- To obtain investment manager monitoring that does not require significant Trustee input or time.

- To achieve competitive investment management and investment advisor fees.
- To provide a Plan framework which allows the most efficient fund switching possible in order to reduce members' out-of-market risk.

The Trustee regularly reviews the suitability of the options provided and from time to time will change or introduce additional investment options as appropriate.

### 3.2. Risk

The Trustee has considered risk from a number of perspectives. The risks considered are:

- **Market Risk** – The risk that low investment returns over members' working lives or unfavourable market movements in the years just prior to retirement will secure an inadequate pension.
- **Interest Rate Risk** – The risk that unfavourable interest rate movements, particularly in the years just prior to retirement may lead to a reduction in the pension that the member's retirement account can secure.
- **Inflation Risk** – The risk that investments do not keep pace with inflation.
- **Manager Risk** – The risk that the chosen underlying investment manager underperforms the benchmark against which the manager is assessed. In particular, the Trustee has considered the risk that active managers may underperform, whereas passive managers are likely to achieve a return close to any chosen benchmark. The Trustee believes active management skills exist and can be identified but not with complete certainty. As such the Trustee makes available to members both actively managed and passively managed funds.
- **Mismatch Risk** – It is expected a proportion of members will purchase an annuity at retirement and there is the risk that the value of a member's investments does not move in line with the cost of the annuity. The Trustee has made available to members a range of bond funds that can be selected by members as they approach retirement.
- **Liquidity Risk** – The pooled funds in which the Trustee allows members to invest provide the required level of liquidity. Units in the pooled funds in which the Plan invests are believed to be readily redeemable.
- **Concentration Risk** – The Trustee has made a range of funds available to members, so that they can choose to invest in a well diversified portfolio. The range of funds enables diversification by asset class (e.g. equity, bonds, cash), by region and includes both passively and actively managed funds, which can help achieve diversification.
- **Sponsor Risk** – The Trustee has considered the risk that the Company may be unwilling or unable to continue to contribute to the Plan in the future. The Trustee has concluded that this risk is acceptable and that no further action is necessary to mitigate this risk, especially since this would only affect the accrued defined contribution benefits to the extent that any payments due had not yet been paid into the Plan.

- **Exchange Rate Risk** – The Trustee has made available a global equity fund that hedges 95% of its developed market currency exposure in order to manage the exchange rate risk associated with overseas investment. The allocations to global small cap equities and emerging market equities are unhedged. This fund is utilised as part of the Active Diversified Growth Fund and Active Diversified Retirement Fund, within the Diversified Default Option.

The Trustee regularly monitors these risks and the appropriateness of the investments in light of the risks described above.

### 3.3 Diversified Default Option

The Diversified Default Option is the default investment option for the Plan. It is a form of lifestyle strategy. Lifestyle strategies are designed to meet the conflicting objectives of maximising the value of the member's assets at retirement and protecting the member's accumulated assets in the years approaching retirement.

Typically, a proportion of members will actively choose this option because they feel it is most appropriate for them. However, the vast majority of members do not make an active investment decision and are therefore invested in the Diversified Default Option by default.

The aims of the Diversified Default Option and the ways in which the Trustee seeks to achieve these aims, are detailed below:

- **To generate returns in excess of inflation during the growth phase of the strategy whilst managing downside risk.**

The Diversified Default Option's growth phase invests in equities and other growth-seeking assets (by investing in the blended Active Diversified Growth Fund, which is comprised of a passive global equity blend, three absolute return strategies, a multi asset credit strategy and a property fund). These investments are expected to provide equity-like growth over the long term and some protection against inflation erosion. The diversification provided by the component funds is expected to provide some downside protection from equity market falls.

- **To provide a strategy that reduces investment risk for members as they approach retirement.**

As a member's pot grows, investment risk will have a greater impact on member outcomes. Therefore, the Trustee believes that a strategy that seeks to reduce investment risk as the member approaches retirement is appropriate. In view of the above, the Trustee considers the level of risk within the Diversified Default Option in the context of the variability of returns as members approach retirement.

These aims are achieved via automated lifestyle switches over a fifteen year period prior to age 65. Under this approach contributions are invested in the Active Diversified Growth Fund until a member reaches the age of 50. From this age onwards, each quarter, a proportion of each member's accumulated growth assets are switched into the Active Diversified Retirement Fund and then the Cash Fund from age 55, linearly, in the manner described by the following table.

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Years to Age 65									
	above 15	15	14	13	12	11	10	9	8
Active Diversified Growth Fund	100.0%	98.4%	91.8%	85.3%	78.7%	72.1%	65.6%	59.0%	52.5%
Active Diversified Retirement Fund	0.0%	1.6%	8.2%	14.8%	21.3%	27.9%	33.8%	37.9%	42.1%
Cash Fund	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.6%	3.1%	5.5%

Years to Age 65								
	7	6	5	4	3	2	1	0
Active Diversified Growth Fund	45.9%	39.3%	32.8%	26.2%	19.7%	13.1%	6.6%	0%
Active Diversified Retirement Fund	46.2%	50.3%	54.4%	58.5%	62.7%	66.8%	70.9%	75%
Cash Fund	7.9%	10.4%	12.8%	15.2%	17.7%	20.1%	22.6%	25%

- **To provide exposure, at retirement, to assets that are broadly appropriate for an individual planning to use their savings in the Plan as allowed under the freedom and choice legislation.**

At retirement, 75% of the member's assets will be invested in the Active Diversified Retirement Fund and 25% in the Cash Fund. If a member continues in the Plan past age 65, without converting their accumulated assets into a retirement benefit or leaving the Plan, then the allocation will periodically be re-balanced to the 75/25 split.

Brief descriptions of the objectives of each fund within the Diversified Default Option are given in the IPID.

The Trustee's policies in relation to the Diversified Default Option are detailed below:

- The Diversified Default Option manages investment risks through a diversified strategic asset allocation consisting of traditional and alternative assets. Risk is not considered in isolation, but in conjunction with expected investment returns and outcomes for members. In designing the Diversified Default Option, the Trustee has considered the trade-off between risk and expected returns.
- The Trustee monitors various aspects of the Diversified Default Option as part of their quarterly monitoring reports. This includes monitoring the performance of the investment funds that make up the Diversified Default Option against the managers' return targets, and monitoring the historic variability of returns of the Active Diversified Growth Fund against the MSCI World Index.
- Assets in the Diversified Default Option are invested in the best interests of members and beneficiaries, taking into account the profile of members. In particular, the Trustee has considered high level profiling analysis of the Plan's membership in order to

inform decisions regarding the Diversified Default Option. Based on this understanding of the membership, and the availability of post-retirement solutions in the market at the time of the last review, a Diversified Default Option that targets drawdown at retirement is currently considered appropriate.

- Members are supported by clear communications regarding the aims of the Diversified Default Option and the access to alternative investment approaches. If members wish to, they can opt to choose their own investments from the range of self-select funds available. Moreover, members do not have to take their retirement benefits in line with those targeted by the Diversified Default Option; the target benefits are merely used to determine the investment strategy held pre-retirement.
- Assets in the Diversified Default Option are invested in daily traded pooled funds which hold highly liquid assets. The pooled funds are commingled investment vehicles which are managed by various Investment Managers. The selection, retention and realisation of assets within the pooled funds are delegated to the respective Investment Managers in line with the mandates of the funds. Likewise, the Investment Managers have full discretion (within the constraints of their mandates) on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. The majority of funds are accessed via an Investment Platform and are held through a long-term insurance policy issued by Zurich Assurance Limited ("Zurich").
- The Trustee recognises that the Diversified Default Option is not a perfect match for any individual member's circumstances. In particular, this option provides little protection for the risk facing members who retire early or at short notice and who have either not yet reached the switching stage or are only partially through the switching process.
- Taking into account the demographics of the Plan's membership and the availability of post-retirement solutions in the market, the Trustee believes that the current Diversified Default Option is appropriate and will continue to review this over time, at least triennially, or after significant changes to the Plan's demographic, if sooner.

### **3.4 Additional Range of Funds**

In addition, a range of self-select funds is offered to members.

The Trustee believes that the risk identified in Section 3.2 and objectives in Section 3.1 are best met by offering members a range of investment funds from which to choose. Full details of the funds currently available to members of the Plan can be found in the IPID.

## **Defined Benefit ("DB") Section**

### **4. Background Information**

The Plan retains a Final Salary element where the liabilities consist of deferred pensioners and pensioners only. The pensioner liabilities are secured through insurance policies.

In considering the appropriate investments for the Plan the Trustee obtained and considered the written advice from the Investment Consultant whom the Trustee believes to be suitably qualified to provide such advice.

## **5. Investment Objectives**

- 5.1. The Trustee is required to invest the Plan's assets in the best interest of the members, beneficiaries and the Company and in the case of a potential conflict of interest in the sole interest of the members and beneficiaries.
- 5.2. The Plan's funding basis is based on assumptions determined in such a way as to estimate the cost of securing the benefits built up in the Plan with an insurance company. As at 31 December 2015, prior to retirement the assets are assumed to grow as follows:
- i) Up to 14 years from retirement: the higher of corporate bond yield minus 0.5% or nominal swap yield plus 0.3%;
  - ii) 15 or more years to retirement: nominal swap yield.

The Trustee's current policy is for benefits to be bought out with an insurance company on retirement. The way in which these assumptions are determined may change from time to time to reflect changes in the insurance market. The Trustee and Company are will review the feasibility of obtaining a buy-in policy as part of the next actuarial valuation.

- 5.3. The Trustee has therefore concluded that the investment objective should be to continue to invest the Plan's assets to minimise the volatility of the Plan's deficit.

## **6. Risk Management and Measurement**

The Trustee has considered the risks to which the DB Section of the Plan is exposed, and has agreed the following policies on risk management:

- **Interest rate and inflation risk** – The Trustee recognises that the value of the Plan's liabilities will change in response to changes in interest rates and inflation. The Trustee's policy is to hedge this risk as far as possible. It is acknowledged that it is not possible to completely eliminate this risk due, for example, to an element of uncertainty in the Plan's liabilities.
- **Asset volatility** – The Trustee recognises that investment in asset classes such as equities gives rise to volatility in the value of the assets. The Trustee's policy is to invest in asset classes which closely match the Plan's liabilities, so that this risk is significantly reduced.
- **Counterparty credit risk** – The Trustee may make use of interest rate and inflation swaps to hedge the Plan's interest rate and inflation risks. The Trustee recognises that if the counterparties to these contracts default, the Plan may experience losses. The Trustee has reviewed the counterparty risk management processes of the appointed swap execution manager, and is satisfied that this risk is substantially mitigated. In particular, the use of swaps is collateralised, the credit quality of the counterparties is kept under review, and there is some diversification of swap counterparty exposure.

- **Credit risk** – The Trustee invests in corporate bonds and money market instruments such as Floating Rate Notes. The Trustee recognises that any defaults or downgrades of these instruments may result in losses. This risk is partially mitigated by investment in a range of different credit instruments (via pooled funds). The Trustee is satisfied that the remaining risks are acceptable.
- **Liquidity risk** – The Trustee recognises that the liquidity of investments may change over time, and this may have an impact on the expected transaction costs. The Trustee has reviewed the likely cash requirements of the Plan, and is satisfied that the investment arrangements provide sufficient liquidity. In addition, the Trustee explicitly considers transaction costs before any major restructuring of the Plan's assets.
- **Longevity risk** – The Trustee recognises that longevity experience may differ from expectations, and that expectations may change over time. The purchase of annuities for pensioners mitigates a substantial portion of this risk.
- **Risks relating to the GMP underpin** – The Plan has an obligation to provide additional defined benefits for some DC members if the value of each member's DC assets are insufficient to secure a minimum level of benefits at retirement. The Trustee recognises that it is therefore exposed, to a certain extent, to the risks arising from these members' underlying assets. The Trustee recognises that there are limited options available to mitigate this risk, but monitors the situation on a regular basis.
- **Custody of assets** – The Trustee has considered the risk relating to the safekeeping of the Plan's assets. Given that the Plan invests in pooled funds, the safekeeping of the underlying assets is undertaken by parties selected by the fiduciaries of the pooled funds.



## **7. Investment Strategy**

In order to minimise deficit volatility in accordance with the Trustee's investment objective, the Trustee invests the Plan's assets in a range of fixed income and inflation-linked instruments. Specifically, the Trustee may invest in:

- Fixed interest and index-linked gilts.
- Interest rate and inflation swaps (backed by money market instruments).
- Corporate bonds.

The specific instruments held and the split between the above has been chosen to closely match the profile of the Plan's liabilities, and may change over time to reflect changes in the liability profile.

The Trustee monitors the progression of the Plan's financial position given the investment objectives set out above, to assess whether the realised outcome is proving consistent with the level of risk expected, on an ad hoc basis.

A review of the investment strategy will result from observations that indicate that the risk tolerance has been breached.

## **Both Sections**

### **8. Day-to-Day Management of the Assets**

#### **8.1. Additional Assets**

- **Additional Voluntary Contributions ("AVCs")**

AVCs can be invested in any of the DC fund options described in Section 2 of the IPID.

There are also some additional assets in respect of AVCs held with Standard Life in its With Profits and Unit-Linked funds. However, these options are only open to existing contributors to these funds.

- **Cash Balances**

The Trustee retains small working cash balances in a conglomerate bank account administered by Capita HR & Payroll Services.

- **DC Unallocated Reserves**

Historically non-vesting Company contributions, arising as a result of Plan members who leave the DC section of the Plan with less than two years' service, have been treated as part of the DB section's assets. Since April 2006, non-vesting Company contributions have arisen as a result of Plan members who leave with less than three months' service. The unallocated reserves are used by the Firm to fund the DB Section of the Plan.

## **8.2. Realisation of Investments**

In general, the Plan's investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments.

## **8.3. Monitoring the Investment Managers**

The Trustee monitors the performance of the investments on a quarterly basis. Mercer Ltd is retained as the Investment Consultant to advise the Trustee on relevant investment issues.

The Trustee meets with the managers as and when necessary to discuss performance activity and other issues as required.

## **8.4. Socially Responsible Investing**

The Trustee has introduced a new Active Sustainable Equity Fund option for members. The Trustee is satisfied that this is consistent with its responsibilities to members.

The Trustee believes that good stewardship and environmental, social and governance ("ESG") issues may have an impact on investment returns. The Trustee has given the Investment Managers full discretion when evaluating ESG issues and in exercising rights and stewardship obligations attached to the Plan's investments.

Similarly, the Plan's voting rights are exercised by its investment managers in accordance with their own corporate governance policies, and taking account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

## **8.5. Investment Manager Fees**

Details of the Investment Manager fees can be found in the IPID.

## **8.6. Investment Consulting Fees**

Mercer fees are either based on fixed quotes for particular projects or, more normally, are on a fixed cost basis. This approach has proved satisfactory in the past.

Mercer provides advice to the Trustee but does not have responsibility for decision making in any area. The role encompasses, but is not limited to, the following:

- Assistance in helping the Trustee to formulate investment objectives
- Advice on investment strategy

- Assistance in selecting and monitoring of investment managers.

**9. Compliance with this Statement**

The Trustee will monitor compliance with this Statement annually.

**10. Review of this Statement**

The Trustee will review this Statement in response to any material changes to any aspects of the Plan, its liabilities, finances and the attitude to risk of the Trustee and the sponsoring Company which it judges to have a bearing on the stated Investment Policy.

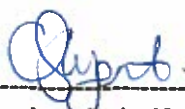
This review will occur at least every three years and without delay after any significant change in investment policy. Any such review will again be based on written, expert investment advice and will be in consultation with the Company.



For and on behalf of the Trustee of  
The Morgan Stanley UK Group Pension Plan

21/6/19

Date



For and on behalf of the Trustee of  
The Morgan Stanley UK Group Pension Plan

24/6/19

Date

June 2019

